United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLANT

74-1277

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To be argued by
ANDREW CONNICK

United States Court of Appeals

FOR THE SECOND CIRCUIT

GEORGE FELDMAN, as Trustee in Bankruptcy of Leasing Consultants Incorporated, Bankrupt,
Plaintiff-Appellee,

against

CHASE MANHATTAN BANK, N.A.,
Defendant-Appellant.

ON APPEAL from the UNITED STATES DISTRICT COURT for the SOUTHERN DISTRICT of NEW YORK

BRIEF OF DEFENDANT-APPELLANT

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Preliminary Statement

This appeal is from the decision rendered by Hon. Arnold Bauman, United States District Court, Southern District of New York, in *Feldman* v. *Chase Manhattan Bank, N.A.*, 368 F.Supp. 1327(1974), and the order and judgment entered thereon on January 28, 1974.

Statement of Issues

1. Whether a lessor's assignment of its right to rentals under an airplane lease is a conveyance affecting an interest in an aircraft within the meaning of 49 U.S.C. § 1403(a), so as to require the recording of that assignment in order to perfect the assignee's security interest in the lease rentals.

2. Whether filing of its chattel mortgage on the airplane with FAA Aircraft Registry and taking physical possession of the lease perfected the assignee's security interest in the lease.

3. Whether the sale of the aircraft by the lessor's trustee in bankruptcy after the assignee's mortgage on the airplane had been fully satisfied through the receipt of rentals under the assigned lease, estops the trustee from contesting the secured nature of the assigned rentals or creates a fund which must be paid to the assignee in satisfaction of its duly filed chattel mortgage if the assignee's interest in the lease rentals is subordinate to that of the trustee.

Statement of the Case

This is an action by a trustee in bankruptcy under § 70c of the Bankruptcy Act, 11 U.S.C. § 110(c), to invalidate the assignment of an aircraft lease made by the lessor bankrupt to defendant bank and to have defendant's interests in said lease declared subordinate to those of plaintiff trustee (A-2)*. In its answer, defendant counterclaimed for proceeds from the trustee's sale of the collateral, together with damages for the dissipation of the collateral and interest to the extent of the sum demanded in the complaint (A-14).

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* Parenthetical references are to the pages of the appendix unless otherwise indicated.

In April, 1973, plaintiff moved for summary judgment pursuant to Rule 56 of the Federal Rules (A18-A46), and thereafter defendant cross moved for summary judgment (A47-A55). The Court determined that no genuine issue exists as to any material fact and directed entry of judgment in favor of plaintiff in the sum of $53,460.00, with interest on the component parts of said sum from the dates defendant received such payments.

Defendant appeals from the order and judgment entered as a result of said determination on January 28, 1974 (A-74).

The Facts

Leasing Consultants, Inc. ("LCI") purchased a Cessna 411 aircraft from Sunny South Corp. A Florida bank held a mortgage on the aircraft which was satisfied by defendant The Chase Manhattan Bank, N.A. ("Chase") and the aircraft was transferred to LCI by bill of sale. As security for its advances to LCI, Chase took a chattel mortgage and security agreement covering the aircraft in the amount of $140,963.20 (A-53). Chase filed with the FAA Aircraft Registry the bill of sale, the chattel mortgage and security agreement (recorded July 19, 1967) and the release of the Florida bank's prior mortgage.

On or about April 25, 1967, LCI leased the aircraft to Zinke-Smith, Inc., now known as Devcon International Corporation ("Devcon"), and on July 11, 1967, assigned the rentals to Chase as further collateral and security for LCI's indebtedness to Chase (A-3 to A-9, A-31). Devcon acknowledged the assignment to Chase and on July 14, 1967, gave a separate commitment to pay all the rentals to Chase notwithstanding the lease obligations (A-55). Chase took possession of and retained at all times relevant herein the lease, its assignment and the separate acknowledgement.

LCI on August 18, 1970 filed a petition for arrangement under Chapter XI of the Bankruptcy Act, and by order

dated October 16, 1970, was adjudicated a bankrupt (A-20). In August and September of 1971 Devcon failed to make its monthly payments until advised by Chase of its delinquency. Thereafter, Devcon sent a letter to LCI's trustee stating that in addition to the lease, they had a purchase option with respect to the aircraft which they desired to exercise (A-62). The trustee found no such purchase option in LCI's files and declined Devcon's request (A-63). Because Devcon had meanwhile again become delinquent in its lease payments, Chase (after advising the trustee's attorney of the delinquency) through its agent, H. J. Gray, Corp., took possession of the aircraft and prepared to sell it at public auction, all in accordance with the provisions of the Uniform Commercial Code. Prior to the public sale, Chase received bids for the aircraft in excess of the appraised valuation of $50,000. On March 20, 1972, however, one day before the intended public sale, Devcon obtained a restraining order prohibiting Chase from conducting the sale and served a complaint on Chase seeking reformation of the lease agreement to include a purchase option (A-25). In a conference held in New York in April, 1972, attorneys for Chase, Devcon and the Trustee agreed that Devcon would pay Chase $18,000 in satisfaction of the remaining rentals due under the lease and in reimbursement of Chase's expenses incurred in taking possession of the aircraft. Thereafter, Devcon filed an amended complaint, substituting the plaintiff herein as a party defendant in lieu of LCI and adding a cause of action against Chase based upon the theory of wrongful seizure (A-33). The $18,000 was received by Chase on January 23, 1973, and from these funds a surplus of $4,497 was paid on April 4, 1973 by Chase to the trustee (A-49). As part of the settlement agreement between Devcon and Chase, Devcon agreed to withdraw any and all claims against Chase, and to execute a general release in its favor. In return, Chase assigned to Devcon any rights it might have had remaining in the aircraft (A-42). Thereafter, the trustee went to Florida to litigate

the action of the purchase option on the aircraft, but settled the action on April 12, 1973, by selling the plane to Devcon for $20,000 (A-45). On March 20, 1973, the trustee commenced this action to have LCI's assignment of the lease to Chase declared subordinate to the rights of the trustee in said payments (A-2).

Summary of Argument

An examination of the provisions of the Federal Aviation Act, its legislative history and the related Regulations reveals that the Act sets up an exclusive national recording system for registering instruments of title to aircraft, comparable to state registration of titles to motor vehicles; security documents of the kinds commonly comprehended by state recording laws concerning written consentual security interests affecting personal property; and notices of tax liens or other instruments affecting interests in aircraft. The Act does not and should not be interpreted to require the recording of interests in accounts or other intangibles arising out of aircraft use or financing such as assigned lease rentals which do not encompass interests in the aircraft itself (Point I).

State law continues to operate except to the extent expressly preempted by the Act, and under the Uniform Commercial Code a security interest in assigned lease rentals represents an interest in chattel paper which may be perfected by possession of the lease (Point II).

Chase filed its chattel mortgage and security agreement pursuant to the requirements of the Federal Aviation Act, thereby perfecting a first mortgage on the aircraft. Plaintiff subsequently sold the aircraft without giving any notice to Chase. This sale by the trustee was either in direct violation of the terms of the chattel mortgage and security agreement and of Chase's rights as a perfected lien creditor, or was an admission by the trustee that Chase's mortgage was no longer viable and no longer a valid lien on the

aircraft by virtue of the rightful payment of the lease installment to Chase. By reason of the foregoing the trustee should be estopped from denying Chase's right to the disputed payments (Point III).

POINT I

The Assignment of a Right to Rentals Under a Lease is Not a Conveyance of an Interest in an Aircraft.

The federal system of recording interests in aircraft was first established by Section 503 of the Civil Aeronautics Act of 1938, 52 Stat. 1006 (1938).[1] This section was repealed and re-enacted in amended form as § 503 of the Federal Aviation Act of 1958, 49 U.S.C. § 1403, 73 Stat. 772, which reads in relevant part as follows: "(a) The Administrator shall establish and maintain a system for the recording of each and all of the following: (1) Any conveyance which affects the title to, or any interest in, any civil aircraft of the United States; * * * (c) No conveyance or instrument the recording of which is provided for by subsection (a) of this section shall be valid in respect of such aircraft, * * * against any person other than the person by whom the conveyance or other instrument is made or given, his heir or devisee, or any person having actual notice thereof, until such conveyance or other instrument is filed for recordation in the office of the Administrator * * * (g) The Administrator is authorized to provide by regulation for * * * the recording of * * * transactions affecting title to or interest in aircraft, * * * and for such other records, proceedings, and details as may be necessary to facilitate the determination of the rights of parties dealing with civil aircraft of the United States, * * *." Although 14 C.F.R. § 49.31 (a) specifically requires recording of a

(1) For a discussion of the history and development of the Civil Aeronautics Act of 1938, see 1 Gilmore, *Security Interests in Personal Property*, § 13.5 (1965); *Dowell v. Beech Acceptance Corporation*, 4 Cal. App. 3d 748, 753, 84 Cal. Rptr. 654, 658 (1970).

"bill of sale, contract of conditional sale, assignment of an interest under a contract of conditional sale, mortgage, assignment of mortgage, lease, equipment trust, notice of tax lien or of other lien, or other instrument affecting title to, or any interest in, aircraft" it makes no reference to an assignment of rentals under a lease as a conveyance affecting any interest in aircraft, and advisedly so. The court in *Industrial Nat. Bank of R.I.* v. *Butler Aviation Int., Inc.*, 370 F. Supp. 1012, 1016 (E.D.N.Y. 1974) citing with approval the case of *Southern Jersey Airways, Inc.* v. *National Bank of Secaucus*, 108 N.J. Super 369, 261 A.2d 399, 403 (App. Div. 1970) recognizes that the intent of Congress in enacting the federal recordation procedure was

> "to substitute for the multiplicity of state registration or recording systems a single preemptive federal system for registering (1) instruments of title, comparable to state registration of titles to motor vehicles, and recording (2) security documents of the kinds commonly comprehended by state recording laws concerning written consensual security interests affecting personal property. The reason was that the mobility of aircraft and their common use across state lines made it cumbersome and burdensome for persons having concern with title to or incumbrances on aircraft to have to record or search in all states or localities which could arguably be claimed to constitute the proper recording situs in relation to the specific owner or incumbrancer of a particular aircraft. * * *"

Holding that Congress did not intend by adoption of the Federal Aviation Act to displace and preempt all state law otherwise applicable bearing upon priorities of lien and title interests in aircraft, the *Butler* and *Southern Jersey* decisions respectively accord priority to a bailee's and a mechanic's unrecorded possessory lien over that of the holder of a properly filed security interest. *Accord, Carolina*

Aircraft Corp. v. *Commerce Trust Company,* 289 So.2d 37 (Fla. App. 1974). These and other cases decided under § 503 seem to assume that state law is generally applicable and that § 503 is clearly an "interstitial" statute, which simply substitutes a federal filing system in lieu of Uniform Commercial Code filing without displacing state priority rules, and that to the extent the Federal Aviation Act does not regulate the rights of parties to and third parties affected by such transactions, security interests in aircraft remain subject to the Uniform Commercial Code or other state laws. See Official Comment 1 to Uniform Commercial Code sections 9-104 and 9-302; *State Sec. Co.* v. *Aviation Enterprises, Inc.,* 355 F.2d 225, 229 (10th Cir. 1966); *Aircraft Inv. Corp.* v. *Pezzani & Reid Equip. Co.,* 205 F. Supp. 80, 82 (E.D. Mich. 1962); 1 Gilmore, *supra* pgs. 423 & 427; Birmingham, "Security Interests in Aircraft" 10 B.C. Ind. & Com. L. Rev. 973, 974 (1969); Sigman, "The Wild Blue Yonder: Interests in Aircraft under our Federal System" 46 S.Cal.L.Rev. 337, 377 (1973).

Personal property security law is an area traditionally governed by state law; it generally regulates relations between private parties involving rights created under state law and apart from the specific purpose of the Federal Aviation Act as set forth above, such area is not likely to present interests in which the federal government has a special concern. When viewed in this context against the rule that where Congress has not clearly indicated a purpose to invade a sphere of control which previously had been regarded as belonging to the states, it will not be held to replace state law, there is little or no justification for extending the preemption of state statutes by the Federal Aviation Act beyond the express provisions and purpose of that Act in order to cover an assignment of lease rentals not affecting a security, reversionary or possessory interest in aircraft. Cf. *United States* v. *Kramel* 234 F.2d 577, 582 (8th Cir. 1956); *Davies Warehouse Company* v. *Bowles,* 321 U.S. 144, 154, 88 L.Ed. 635, 64 S.C. 474 (1944).

POINT II

The Assignment of a Right to Rentals Under a Lease is Perfected by Possession of the Chattel Paper by the Secured Party.

The New York Uniform Commercial Code ("U.C.C.") § 9-105(1)(b) provides that:

> " 'Chattel paper' means a writing or writings which evidence both a monetary obligation and a security interest in or a lease of specific goods; a charter or other contract involving the use or hire of a vessel is not chattel paper. When a transaction is evidenced both by such a security agreement or a lease and by an instrument or a series of instruments, the group of writings taken together constitutes chattel paper;"

As the definition indicates, chattel paper transactions comprehend all kinds of written agreements where a seller or lessor transfers possession and control of the goods to another while retaining a security interest or a lease interest in the goods. The writing which evidences the debt and embodies the security or lease interest constitutes the "chattel paper" which may consist of a conditional sales contract, a chattel mortgage, a security agreement or a chattel lease. Levie, "Security Interests in Chattel Paper" 78 Yale L.J. 935 (1969). The Official Comment to U.C.C. § 9-105, paragraph 4 further explains that:

> "Under the definition of 'security interest' in Section 1-201(37) a lease does not create a security interest unless intended as security. Whether or not the lease itself is a security agreement, it is chattel paper when transferred if it relates to specific goods. Thus, if the dealer enters into a straight lease of the tractor to the farmer (not intended as security), and then arranges to borrow money on the security of the lease, the lease is chattel paper."

Thus, the definition includes all equipment leases assigned as security, even those which if not assigned, would not create a security interest. Levie, *supra,* pg. 940, draws the following distinction between the assignee of a "true" lease (i.e., one in which the lessor at all times owns the property so that there is no security transaction at all) and the owner of an assigned conditional sales contract; Account Debtor, the Dealer, and the Financer are referred to in abbreviated form as "A", "D", and "F":

> "In one situation the purchaser of a security agreement may have an advantage over the purchaser of a lease. Where F purchases equipment leases, he takes only an assignor's interest in the equipment lease itself. If F wishes to be secured by an interest in the goods as well he must obtain a security interest from D and perfect it. A typical example arises when D is leasing computers to A on a three-month basis and F, knowing that such leases are ordinarily renewed, makes an advance that exceeds the balance due on the leases. In this case, F must file a "chattel mortgage" against D in order to perfect his security interest in the inventory of computers which D has rented to A (and probably should also file against D's "contract rights" to cover the renewals). If, however, D is buying computers from his supplier on a conditional sales basis, F may very well have a second security interest in the computers themselves. Contrast the situation where F is financing conditional sales contracts generated by D. There F's security interest in the property comes with its security interest in the paper and the additional "chattel mortgage" is not required; F, a purchase money buyer of D's conditional sales contracts, need not worry about the security interest of D's suppliers."

This example comports with the distinction in 14 C.F.R. § 49.31(a) between assigned contracts of conditional sale and assigned leases and demonstrates the procedure ex-

plicitly followed by Chase in perfecting its interest in the assigned rentals, i.e., by retaining possession of the lease; and in the assigned reversionary interest in the underlying aircraft, by duly filing its chattel mortgage and security agreement with the FAA Aircraft Registry in Oklahoma City, Oklahoma. U.C.C. § 9-305[2]; 49 U.S.C. § 1403(d)[3]. The distinction drawn above in perfecting interests in the assigned lease rentals which do not involve interests in aircraft, and in the assigned reversionary interest in the underlying equipment, although both such interests may be physically encompassed in or represented by a single instrument of assignment or chattel paper, is not a specious one and is specifically approved by this circuit. *In Re Leasing Consultants, Incorporated,* 486 F.2d 367 (2nd Cir. 1973).

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(2) § 9-305. When Possession By Secured Party Perfects Security Interest Without Filing

A security interest in letters of credit and advices of credit (subsection (2)(a) of Section 5-116), goods, instruments, negotiable documents or chattel paper may be perfected by the secured party's taking possession of the collateral. If such collateral other than goods covered by a negotiable document is held by a bailee, the secured party is deemed to have possession from the time the bailee receives notification of the secured party's interests. A security interest is perfected by possession from the time possession is taken without relation back and continues only so long as possession is retained, unless otherwise specified in this Article. The security interest may be otherwise perfected as provided in this Article before or after the period of possession by the secured party. L.1962, c. 553, eff. Sept. 27, 1964.

(3) 49 § 1403 Effect of recording

(d) Each conveyance or other instrument recorded by means of or under the system provided for in subsection (a) or (b) of this section shall from the time of its filing for recordation be valid as to all persons without further or other recordation, except that an instrument recorded pursuant to subsection (a) (3) of this section shall be effective only with respect to those of such items which may from time to time be situated at the designated location or locations and only while so situated: *Provided,* That an instrument recorded under subsection (a) (2) of this section shall not be affected as to the engine or engines, or propeller or propellers, specifically identified therein, by any instrument theretofore or thereafter recorded pursuant to subsection (a)(3) of this section.

Chase at all times relevant herein retained possession of the lease. Therefore, the rentals received pursuant to the assignment are not defeasible by the trustee.

POINT III

The Trustee Should be Estopped From Questioning the Secured Nature of the Assigned Rentals.

Plaintiff should be equitably estopped from asserting against Chase the invalidity of, or any other infirmity pertaining to, the lease. In March of 1972, Chase commenced exercise of its rights as a secured creditor to effect collection of the rentals unpaid as of that time, by taking possession of the aircraft and attempting to sell it at public auction, with the full knowledge of the plaintiff. Had the trustee given notice of its claim to the rental payments, which Chase was endeavoring to collect by said process, and not consented thereto, Chase would not have attempted to recover the moneys due it by the exercise of such rights, but merely allowed the trustee to take possession of the aircraft as owner, subject to the rights of Chase as a secured creditor. Because plaintiff did not object to the attempted sale, Chase changed its position, incurring substantial litigation expenses and other charges, and compromising its interests under the chattel mortgage and security agreement pursuant to the settlement stipulation with Devcon (A-41). Plaintiff sat on his rights at that time by not objecting or advising Chase of his intention to object to the collection of rentals by Chase and should not now, after collection of proceeds of the sale of the aircraft to Devcon, be allowed to assert the invalidity of, or any infirmity pertaining to, Chase's collecting rent due under the lease. *See Feldman* v. *Trans-East Air, Inc., Hudleasco, Inc., and Castle Capital Corporation,* Docket No. 73-2464 (652-September Term 1973 2nd Cir. May 7, 1974) 3289, 3294; *Parsons* v. *Lipe,* 158 Misc. 32, 286 N.Y.S. 61, 107-109 (Spec. T.Sup.Ct. Onondaga Co.

1933, *aff'd per curiam* 269 N.Y. 630, 200 N.E. 31 (1936); *Cf. Beavers* v. *Beavers,* 11 Misc. 2d 247, 177 N.Y.S. 2d 870, 874 (Spec. T.Sup.Ct. N.Y. Co. 1958), *appeal dismissed,* 181 N.Y.S. 2d 758 (1958). *See generally, Lumber Mut. Casualty Ins. Co.* v. *Friedman,* 176 Misc. 703, 28 N.Y.S. 2d 506 (Sup. Ct. N.Y. Co. 1941).

Alternatively, if the rentals obtained under the lease should be deemed subordinate to the rights of the trustee, Chase's assignment of its rights to the aircraft under the chattel mortgage and security agreement (A-42) should be recognized as a release only with respect to Devcon, not a relinquishment of its right to proceeds of the trustee's sale of the aircraft to Devcon (A-45) and without prejudice to Chase's claim against the trustee for diminution of its collateral (A-14). *See, Stewart-Scott Const. Corp.* v. *F. & M. Schaefer Co.,* 41 App.Div. 2d 788, 341 N.Y.S. 2d 269 (App.Div. 3rd Dep't. 1973); *John F. James & Sons, Inc.,* v. *Burdeau,* 258 App.Div. 1077, 18 N.Y.S. 2d 36 (App.Div. 2nd Dep't. 1940); *Friedman Marble & Slate Works* v. *Whitcomb,* 186 App.Div. 509, 174 N.Y.S. 531 (App.Div. 1st Dep't. 1919).

Conclusion

For the reasons set forth above, the judgment appealed from should be reversed.

Respectfully submitted,

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